The New York Times
nytimes.com

August 9, 2006

San Diego Broke Laws in Pension Crisis, Panel Says

By MARY WILLIAMS WALSH

Independent experts brought in to help San Diego dig its way out of a deepening financial hole said yesterday that city officials broke federal securities laws and other statutes as they tried to conceal their failure to put enough money into the city's pension fund for police, firefighters and other public employees. The investigators, led by a former Securities and Exchange Commission chairman, Arthur Levitt Jr., recommended that San Diego be placed under the supervision of an independent monitor who would report to the S.E.C.

They also said the city should adopt changes similar to those undertaken by the private sector in recent years, as American business has sought to restore confidence in the wake of big accounting scandals at Enron and other companies.

San Diego officials had hoped Mr. Levitt's report would represent a conclusion to years of financial turmoil, but it did not offer any simple answers that quarreling city officials could rally around.

"The city's pension system was not brought to a crisis merely as a result of abnormally low investment returns," Mr. Levitt told city officials, dismissing an explanation frequently cited for pension problems in San Diego and elsewhere. "Nor was the system brought to a crisis as a result of a 'perfect storm' of unpredictable catastrophes."

Instead, Mr. Levitt said, "San Diego officials fell prey to the same type of corruption of financial management and reporting that afflicted municipalities such as Orange County, and such private sector companies as Enron, HealthSouth and any number of public corporations."

Officials created a maze of calculations and artificial devices to make it look as if the pension fund was in fine shape. But in reality, it was developing a shortfall currently measured at $1.4 billion.

In a 266-page report, Mr. Levitt presented lists of city officials, divided into categories according to which laws they were said to have broken. Some had demonstrated willful intent to deceive the public, he said, while others had merely shown negligence or failed in their fiduciary duties.

Over the years, the manipulations spilled over into other areas, and the investigators even cited violations of the Clean Water Act, as officials overcharged homeowners for their sewer bills to protect favored businesses from the rising cost of sewer maintenance.

Many of the officials said to have broken laws are no longer in office. The report also cited failures by the outside law firms and finance professionals who were helping the city run its pension fund and issue bonds.

Mr. Levitt said the city needed to strengthen its internal financial controls, and recommended that a permanent audit committee be established to provide continuous independent oversight. He also said San Diego needed to be a safe place for whistle-blowers to bring their concerns about financial wrongdoing. When a whistle-blower first tried to call attention to the pension problems, in 2003, the city's ethics commission charged her with revealing confidential information. She has since been cleared.

Mr. Levitt also recommended that senior city officials be required to personally certify that financial reports were accurate, much as top corporate executives have been required to do under the post-Enron reform law known as Sarbanes-Oxley.

The city has not been able to issue audited financial statements since 2003 because of legal questions about its pension fund, and it is barred from raising money by selling its bonds on the public markets. Cut off from an essential source of cash, San Diego has come under mounting pressure to get to the bottom of its legal problems.

An official of the S.E.C. declined to comment on whether the commission would be willing to work with an independent monitor to restore San Diego's legal standing. The S.E.C. normally polices corporate wrongdoing, and the appointment of an independent monitor is often part of its settlements when it sues companies for accounting fraud.

But the S.E.C. is much less active in policing municipal finance, and taking a stand on the San Diego pension troubles would be unusual. It would have to first sue the city, something it has not yet done, although it has been investigating San Diego's finances for several years.

Mr. Levitt said in a special city council meeting called yesterday to deliver his report that his findings did not preclude additional work by other investigators. Problems with the San Diego pension fund have spawned a number of lawsuits, investigations by private consultants and government agencies, and criminal charges.

Mr. Levitt's investigative team was hired after previous investigations failed to satisfy the city's outside auditors. KPMG, which is still working on San Diego's annual report for 2003, requested that Mr. Levitt's team clarify a number of legal and accounting issues that the previous investigations raised. Another auditing firm is working on the reports for the years after that.

City officials who heard Mr. Levitt's findings in a special city council meeting yesterday seemed torn between their desire to follow his instructions and hasten a return to normalcy, and their anguish as it became clear that fulfilling his recommendations would mean still more time and more pain.

"I'm sitting here more upset than I've ever been as your representative," said Tony Young, a middle school teacher and president pro tem of the San Diego City Council. He said he was fully committed to cleaning house.

But he asked again and again how much longer it would be before the outside auditors would sign off on the city's accounts, and just what the city had to do to get a green light.

Mr. Levitt's investigation took about 18 months and has cost the city $20 million. Even though it explains in great detail what went wrong, it does not answer the biggest question of all: Where the city will find the $1.4 billion it will take to make the municipal pension fund fully solvent.